🔁 Reclassifying Short-Term Liabilities

📘 Core Standards

- **ASC 470-10-45**: Debt classification and refinancing rules.
- **ASC 855**: Subsequent events—recognized vs. non-recognized.
- **IFRS 9**: International comparison (less strict on refinancing ability).

1️⃣ Classification Overview

Liability Type	Time Frame	Examples
Current	≤ 1 year or operating cycle	A/P, short-term notes, current portion of long-term debt
Long-Term	> 1 year or operating cycle	Bonds, mortgages, notes payable beyond 12 months

🧠 *Exam Tip*: Reclassification affects liquidity ratios like **current ratio** and **working capital**.

2️⃣ Reclassification Criteria (ASC 470)

To reclassify short-term debt as long-term, both must be true **before FS are issued**:

✅ Intent to Refinance

- Must plan to extend maturity beyond 1 year.

✅ Ability to Refinance

Proven by either:

- **Completed Refinancing**: Transaction finalized before FS issuance.
- **Firm Financing Agreement**: Non-cancelable, with covenant compliance.

Scenario	Reclassify?	Notes
Refinancing completed Jan 5, FS issued Jan 10	✅ Yes	Recognized event
Agreement signed Jan 8, FS issued Jan 15	✅ Yes	Firm agreement
Refinancing done Feb 1, FS issued Jan 20	❌ No	Too late

🧠 *Common Trap*: Intent alone or past history ≠ ability.

3️⃣ Subsequent Events (ASC 855)

Type	Impact	Example
Recognized	Adjust FS	Refinancing completed post-BS but pre-issuance
Non-Recognized	Disclose only	New loan signed after FS issuance

🧠 *Exam Tip*: Only **pre-issuance** events affect classification.

4️⃣ Practical Examples

📊 Scenario Breakdown

Liability	Amount	Classification
Serial Bonds	$10M ($1M due in 1 yr)	$1M current, $9M long-term
Mortgage	$3M (5-year balloon)	$3M long-term
Note	$2M (6-month maturity + 2-yr agreement)	$2M long-term
Partial Refinancing	$500K, $300K refinanced	$300K long-term, $200K current

🧮 *Total Long-Term*: $9M + $3M + $2M = **$14M**

5️⃣ Journal Entries

No Reclassification:

plaintext

Dr. Interest Expense $X

  Cr. Notes Payable (Current) $X

With Reclassification:

plaintext

Dr. Notes Payable (Current) $X

  Cr. Notes Payable (Long-Term) $X

🧠 *Exam Tip*: Match journal amounts to reclassified portion exactly.

6️⃣ Common Pitfalls

❌ Classifying all serial bonds as long-term ❌ Including refinancing done after FS issuance ❌ Ignoring covenant compliance in agreements ❌ Mixing up recognized vs. non-recognized events ❌ Miscalculating current vs. long-term split

7️⃣ IFRS Comparison (IFRS 9)

Feature	US GAAP	IFRS
Reclassification	Strict (proof required)	More flexible
Subsequent Events	Must be pre-issuance	Similar, more judgment-based
Covenant Compliance	Mandatory	Less emphasized

🧠 *CMA Tip*: IFRS may allow reclassification with less documentation.

8️⃣ Balance Sheet Impact

- **Improves liquidity ratios** (e.g., current ratio).

- **Disclosures required**: Refinancing terms, agreements, and timing.
- **Presentation**: Split current vs. long-term portions clearly.

🚀 **Study Strategy**

✅ **Memorize**:

- Two criteria: intent + ability
- Timing: pre-issuance only
- Event types: recognized vs. non-recognized

✅ **Practice**:

- Splitting liabilities
- Journal entries
- Partial refinancing logic

✅ **Use Flashcards**:

- Key terms: current vs. long-term, refinancing agreement, subsequent events

✅ **Mock Exams**:

- Gleim, Wiley—focus on scenario-based questions
- Target accuracy in calculations

🔄 **Bonus: Decision Tree for Reclassification**

plaintext

Is the liability due within 1 year?

|

├— Yes → Is there intent to refinance?

| |

| ├— Yes → Is ability proven (refinancing or firm agreement)?

| | |

| | ├— Yes → Reclassify as long-term

| | └— No → Keep as current

| └— No → Keep as current

└— No → Already long-term